

READ AND STEVENS, INC.

IBLA 82-488

Decided February 8, 1983

Appeal from decision of the New Mexico State Office, Bureau of Land Management, rejecting the bid for competitive oil and gas lease NM 50916.

Affirmed.

1. Oil and Gas Leases: Competitive Leases -- Oil and Gas Leases: Discretion to Lease

The Secretary of the Interior has the authority to reject a high bid in a competitive oil and gas lease sale where the record discloses a rational basis for the conclusion that the amount of the bid was inadequate.

2. Oil and Gas Leases: Generally -- Oil and Gas Leases: Competitive Leases

The Minerals Management Service is the Secretary's technical expert in matters concerning geologic evaluation of tracts of land offered at a sale of competitive oil and gas leases and the Secretary is entitled to rely on its reasoned analysis.

APPEARANCES: S. B. Christy IV, Esq., Roswell, New Mexico, for appellant; Robert J. Uram, Esq., Department Counsel, Office of the Field Solicitor, Department of the Interior, Santa Fe, New Mexico, for the Bureau of Land Management.

OPINION BY ADMINISTRATIVE JUDGE FRAZIER

Read & Stevens, Inc., has appealed from a decision of the New Mexico State Office, Bureau of Land Management (BLM), dated December 29, 1981,

rejecting its high bid of \$216.07 per acre for parcel 8 at the competitive oil and gas lease sale held on October 28, 1981. 1/ BLM stated that the Deputy Conservation Manager for Resource Evaluation, Geological Survey recommended rejection of the bid because it was lower than the presale evaluation of the parcel. The recommendation for rejection stated:

Parcel No. 8 consists of 120 acres in T16S, R31E, section 21 in Eddy County, New Mexico.

This parcel is located on the northern extremity of Square Lake Grayburg production which has been producing under a secondary recovery water flood project. A similar tract, located approximately 1 mile to the southeast, sold for \$418.23/acre (total - \$50,187.80) as parcel No. 2 in the September 16, 1981 Santa Fe Sale. [2/] The presale value of parcel 8 was based upon this bid and consequently is in excess of the high bid of \$216.67/acre (total - \$26,000.00) submitted by Read & Stevens.

When appellant requested subsidiary factual data upon which Geological Survey based its recommendation the Deputy Minerals Manager, Minerals Management Service (MMS), 3/ replied as follows:

Parcel No. 8 consists of 120 acres in W 1/2 NW 1/4, NW 1/4 SW 1/4, sec. 21 T. 16 S., R. 31 E., Eddy County, New Mexico. The parcel is located on the northern extremity of the Square Lake Grayburg field. Oil production from this unit is from the Grayburg-San Andres formations. This unit is producing under a secondary recovery water flood project. On September 16, 1980, a parcel located on SE 1/4 SW 1/4, SW 1/4 SE 1/4 sec. 22, T. 16 S., R. 31 E. and NE 1/4 NW 1/4, NW 1/4 NE 1/4 sec. 27, T. 16 S., R. 31 E., was offered by competitive bidding. There were seven bids submitted on this parcel with a high bid of \$418.23 per acre. The potential on this tract is from the Grayburg-San Andres formations. Based on the close proximity of the parcel offered in September, 1980 Parcel No. 8 of the October 1981 sale, and to the potential of obtaining oil from the Grayburg-San Andres formations, it was determined by the MMS (formerly U.S. Geological Survey) that the two parcels were comparable to each other and that Parcel No. 8 should have approximately the same value on a per acre basis as the value received on the parcel of the September 1980 sale.

In the statement of reasons appellant asserts that no subsidiary factual data were ever furnished, that the letter of the Deputy Minerals Manager

1/ Parcel 8 contains 120 acres in T. 16 S., R. 31 E., New Mexico principal meridian, sec. 21 in Eddy County, New Mexico.

2/ The date of this sale was 1980 rather than 1981.

3/ By Secretarial Order No. 3071 published in the Federal Register on Feb. 2, 1982, 47 FR 4751, the Secretary created the Minerals Management Service to inter alia, take over the function of the Conservation Division, Geological Survey.

is conclusory in nature, and that the requirements of Southern Union Exploration Co., 51 IBLA 89 (1980), were not met. With its statement of reasons, appellant has submitted the report of a petroleum geologist. Appellant contends that the report clearly shows its bid to be reasonable. The report evaluates the shallow potential of four wells in close proximity to parcel 8, and concludes that all are "not economic" either as oil or gas producers. With respect to deep potential the report states:

II. Deep Potential

Read & Stevens, Inc. believes that there is a high risk, deep potential under the track [sic] (NM-50916). A well would have to be drilled to 12,500 at the approximate cost of 1.5 million dollars. The projected reserves would be approximately 2.4 BCF and the risk factor would be an industry standard of 1 out of 8 success ratio. The cost of acreage must be limited to the Read & Stevens bid to give a satisfactory return on investment. The acreage in the tract is worth the amount of Read & Stevens bid, but not more than that bid.

Read & Stevens criteria for any prospect is at least a 3:1 return on investment.

AFE cost for completed well to 12,500 is \$ 1,500,000.
 Land cost 320 ac X \$216.66/ac \$ 69,333.
 \$ 1,569,333.

Value of Product

FERC price per MCF	\$2.90
Tax (10%)	.29
Lease operating expense (12%)	<u>.35</u>
Net/MCF	\$2.26

Estimated reserves: 2,400,000 MCF

MCF of gas to payout well = $\frac{\$1,569,333}{\$2.26 \times 87.5\%} = 793,594 \text{ MCF}$

For a 3:1 return on investment:
 793,594 MCF X 3 = 2,380,782 MCF

Conclusion

The estimated reserves of a deep prospect will give slightly over a 3:1 return on investment given the above parameters. If the cost of acreage were any higher a 3:1 return on investment would not be obtainable. There is no risk factor figured in these economics.

Further, the report challenges the comparable tract used by MMS, contending that four out of five offsetting wells are "near payout or have shown a profit."

As part of its reply on appeal, BLM has submitted a portion of the "Evaluation Comments" (Comments) on parcel 8 and a sketch map showing the well situation as of October 1981. The comments are in response to the report of appellant's geologist (hereinafter "report"). ^{4/} The comments explain that the first well listed in the report was a dry hole drilled in 1930 and was not considered in the evaluation. The comments state that the second well listed in the report had produced 123,764 mcf as of October 1981 and 128,214 mcf as of January 1982, 2,136 mcf in January alone. The comments explain that the third and fourth wells listed in the report are converted injection wells active in secondary recovery and responsible for a 10-fold increase in the production of adjacent wells. It is pointed out that secondary recovery in the area has produced three times the amount gleaned from primary recovery; viewed from this perspective, the wells are economic. The comments also challenge the report's conclusion that production from offset wells have not produced commercial amounts of hydrocarbons:

We disagree with Mr. Harle's [author of appellants' report] statement on page 3 of his report, wherein he says, "The production from the offset wells has not produced commercial amounts of hydrocarbons." We also disagree with his other conclusions. On our map wells 3, 5, 6, 8, 10, 13, 14, and 18 were active injection wells in October 1981. Well 16 was plugged as an injection well because it apparently was no longer needed to push oil. Wells 2, 4, 7, 9, 11, 12, 15, and 19 were all producing an average of over 200 bbls. per month in October 1981, and they are still producing, and their history shows an increase since the secondary recovery began to take effect. How can Mr. Harle say this is not an economic formation when it is still in production? The producers surely disagree, or they would have shut down the area. We feel that Parcel No. 8 must be under some influence of the local secondary recovery operation and that it would be an economic lease location at a bonus of \$400. per acre. The report's negative conclusions with respect to parcel 2 are countered as follows:

Again, legal description of Parcel No. 2 of September 16, 1980, is in error. Mr. Harle's page is apparently an attempt to show that Parcel No. 2 on the September 16, 1980, sale was better than the subject parcel. We can discount his attempt by stating that his data is totally misleading; i.e., every well he used was either a dry hole or a plugged and abandoned well in September of 1980. (See our map, wells A thru G and Y) However, Parcel No. 2 received a high bid of \$418.23/acre in spite of the lack of active production!!

Parcel No. 2 on the September 16, 1980, sale received a high bid of \$418.23/acre because of the potential for (a) additional

^{4/} The MMS cover memorandum accompanying the document is dated May 25, 1982. The comments indicate that they are to be considered to reflect the values as of October 1981, and specifically address the points raised in the report submitted by appellant.

secondary recovery and (b) possible deeper production. Incidentally, Read & Stevens only bid \$32.56 for this parcel; they were the fourth-high out of seven bidders. (see our Exhibit "Z") Apparently, the parameters utilized by Read & Stevens to evaluate a tract for their type of operation do not reflect what the market indicates at all times.

The conclusory paragraph again indicates that an important element of MMS's evaluation of parcel 8 was its proximity to, and the likelihood of influence by an active and economic secondary recovery operation.

Counsel also challenges as unwarranted appellant's assumption that a fair return on investment is 3 to 1.

[1] The Secretary of the Interior has discretionary authority to reject a high bid for a competitive oil and gas lease as inadequate. 30 U.S.C. § 226(b) (1976); 43 CFR 3120.3-1. This Board has consistently upheld that authority so long as there is a rational basis for the conclusion that the highest bid does not represent a fair market value for the parcel. Harold R. Leeds, 60 IBLA 383 (1981); Harry Ptasynski, 48 IBLA 246 (1980); B. D. Price, 40 IBLA 85 (1979). Departmental policy in the administration of competitive leasing program is to seek the return of fair market value for the grant of leases and the Secretary reserves the right to reject a bid which will not provide a fair return. Coquina Oil Corp., 29 IBLA 310, 311 (1977). See Exxon Co., U.S.A., 15 IBLA 345, 357-58 (1974).

The Board has consistently held that while BLM is entitled to place great reliance on MMS's technical expertise, the decision rejecting a high bid is that of BLM and, thus, BLM must analyze independently the question of sufficiency. William C. Welch, 60 IBLA 248 (1981); see also Southern Union Production, 51 IBLA 89 (1980); Steven Lutz, 39 IBLA 386 (1979).

Under Southern Union, *supra*, an appellant who has submitted a high bid which is not clearly spurious, must be informed not only of the estimated minimum values, but the subsidiary factual data which served as a predicate for the derivation of the estimate of the parcel's value. In our view, the requisite factual data was disclosed in the February 17, 1982, letter by the Deputy Minerals Manager. The only additional factor, as we have noted, was that of proximity to a secondary recovery system analyzed in some detail in MMS's comments. We cannot agree, therefore, that appellant was not apprised of the subsidiary factual data underlying the Government's valuation. 5/ In any event, MMS's comments on appeal similarly apprised appellant of factors deemed relevant in its assessment.

[2] We find that MMS's comments present evidence which preponderates over the analysis of appellant's report and adequately indicates fair market

5/ In an answer to reply, appellant has objected to MMS's comments on the ground that part I thereof has not been included. However, appellant has registered no challenges to those portions of the comments which were included. We perceive no impediment, therefore, to consideration of the comments as evidence of record.

value. The comments present concise data for the various wells and integrate these data into a cogent picture of the value of parcel 8 in particular and the adjacent area in general. The evaluations in appellant's report of the four wells and of parcel 2 are credibly rebutted by MMS's responses, which tend to dispel any doubt as to the inadequacy of appellant's bid.

MMS is the Secretary's technical expert in matters concerning geologic evaluation of tracts of land offered at a sale of competitive oil and gas leases and the Secretary is entitled to rely on reasoned analysis. Harold R. Leeds, supra; Gerald S. Ostrowski, 34 IBLA 254 (1978); Coquina Oil Corp., supra; Arkla Exploration Co., 25 IBLA 220 (1976). When BLM relies on that analysis in rejecting a bid as inadequate, it must ensure that a reasoned explanation is provided for the record to support the decision. Southern Union Exploration Co., 41 IBLA 81, 83 (1979). MMS's comments provide such explanation. Appellant's arguments on appeal represent its evaluation of the fair market value of the parcel, but do not present definitive evidence which overcomes the recommendation of MMS. As noted, the Secretary is entitled to rely on MMS's assessment of fair market value so long as it is rationally based.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision of the New Mexico State Office is affirmed.

Gail M. Frazier
Administrative Judge

We concur:

Anne Poindexter Lewis
Administrative Judge

James L. Burski
Administrative Judge

